CHAPTER 1

INTRODUCTION

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Definition of an Appraisal. An appraisal is an opinion or an estimate of value. In Arizona, appraisals for tax purposes are ad valorem (according to value). The ad valorem appraisal produces a statement of "market value" or "full cash value." As used in this manual, these terms are synonymous if no statutory valuation method is prescribed.

Definition of Mass Appraisal. "Mass Appraisal of Real Property"[1], a publication by the International Association of Assessing Officers, authored by Robert J. Gloudemans, defines mass appraisal as the "systematic appraisal of groups of properties as of a given date using standardized procedures and statistical testing." Mass appraisal evolved out of the need for uniformity and consistency in ad valorem appraisals.

Additionally, Gloudemans points out in his book, "Improvements in mass appraisal accelerated with the introduction of computers in the 1950s, and these computers were first used primarily in large jurisdictions that could afford the expense. By the late 1980s, jurisdictions with 10,000 parcels could afford a system, including several workstations, a printer, and generic (general-purpose) software, capable of supporting their needs. Hardware and software improvements and cost reductions continue. The power of desktop computers and low costs have led many agencies to migrate to personal computers (PCs), often tied to a 'server' or other computers in networks." The integration of a mass appraisal system with a land record system, and geographic information system, have allowed users to effectively and efficiently implement mass appraisal.

Definition of Land. Legally defined, land comprises a portion of the earth's surface, together with the earth below it, the space above it, and all things annexed thereto by nature or by man. Economists define land as the surface of the earth, and all the natural resources and natural productive powers over which possession of the earth's surface gives man control. For the purpose of appraisal, land is defined as real property exclusive of improvements.

Definition of Improvements. Anything done to land with the intention of improving its value.

1. **Improvements-on-the-land.** Improvements constructed on a site to facilitate its use for a specific purpose. Improvements-on-the-land includes buildings, fences, and driveways,

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parking surfaces, retaining walls and similar items. Retaining walls that are constructed to make a site buildable may be considered as part of the land value.

2. **Improvements-to-the-land.** Improvements to make the land usable and/or prepare the property for the construction of improvements-on-the-land. Improvements-to-the-land includes sewers, drains, leveling, backfilling, compacting and other engineering activities, landscaping, and similar enhancements. In land valuation these items are considered in the value of the land and not as part of the building value.

3. **On-site improvements.** Improvements made "to" the building site/parcel that may include both improvements "on" the land as well as improvements "to" the land.

4. **Off-site improvements.** Improvements made outside of the building site/parcel boundary. Typical off-site improvements include such items as streets and utilities and in some instances may comprise a clubhouse, swimming pool or a tennis court.

Legal Definition of Value. Property tax in Arizona is an ad valorem tax based upon "full cash value", which is the statutory standard for taxation purposes. A.R.S. § 42-11001(5) specifies "full cash value for property tax purposes means the value determined as prescribed by statute. If no statutory method is prescribed, full cash value is synonymous with market value, which means the estimate of value that is derived annually by using standard appraisal methods and techniques."

Statutory definition characteristics:

a) Full cash value is synonymous with market value.

b) Full cash value is an estimate that is derived annually.

c) Full cash value is derived by the use of standard appraisal methods and techniques, with exceptions where statutory methods are prescribed.

Statutory requirements of "full cash value" or "market value". Current use of the property shall be included in the application of standard appraisal methods and techniques, and "if the methods and techniques prescribe using market data as an indication of market value, the price paid for future anticipated property value increments shall be excluded". A.R.S. § 42-11054(B). As prescribed by Arizona law, current use has replaced "highest and best use" as the standard for market value appraisal.

Department of Revenue v. Transamerica Title Insurance Company. "Market value" has been defined by the court in the case of Department of Revenue v. Transamerica Title Insurance Company, Court of Appeals of Arizona, 570 p.2d 797, 117 Ariz 26 (1977). The court defined "market value," which is the basis for assessment of property taxes, as the highest price estimated in terms of money which property will bring if exposed for sale in an open market, allowing a reasonable time to find a purchaser who buys with knowledge of all uses to which it is adapted and for which it is capable of being used.

Burns v. Herberger. Decisions by the courts have addressed the statutory definition of "full cash value". In Burns v. Herberger, 498 p.2d 536, 17 Ariz. App. 462 (1972), the Court of Appeals decided that property must be appraised for ad valorem tax purposes with consideration of its current use as a modification of the "full cash value" definition.

Golder v. Department of Revenue. The Arizona Supreme Court further interpreted the statutory value standard in Golder v. Department of Revenue, State Bd. Of Tax Appeals, 599 P.2d 216, 123 Ariz. 260 (1979). The court decided that "current use" could reasonably be interpreted to include holding for investment purposes (speculative purposes). In the Golder case, the court agreed that "full cash value" means the price that a willing buyer will pay to a willing seller in a cash transaction. Thus, the court's decision in the Golder case requires the County Assessor to base assessment on cash sales, or to make appropriate adjustments to market data where few cash sales occur.

Economic Determinants of Value. Property has value when it possesses utility and scarcity. Its value is determined by the supply and demand for that type of property.

1. **Utility.** Utility may be defined in various ways. One definition is "the capacity to excite desire for possession." Some economists call it the quality of "wantedness." The British economist Alfred Marshall defined it as the want-satisfying power of the commodity. Utility is not the same as usefulness. Its nature is essentially psychological, and it depends on the views of buyers and sellers in a market. For instance, diamonds have utility because most people desire to possess them. This desire, in most cases, has little

to do with their usefulness as an industrial tool. Utility is subjective and need not be logical.

2. **Scarcity.** Scarcity is the other quality that gives property value. Air has utility, but because it is not scarce it is not an economic good. A commodity is scarce when it requires time and effort to obtain so that people must economize the use of it. Just as utility without scarcity does not lead to value, so scarcity without utility does not give value. Mosquitoes are scarce in winter, but as they possess no utility they have no value. Property has value because it yields or is expected to yield services that are scarce.

3. **Supply and demand.** Value is determined by the utility of the property, the purchasing power of those interested in acquiring it, the scarcity of the property, and the degree of difficulty involved in overcoming this scarcity. In other words, value is determined by supply and demand.

   a) A demand schedule is the most of a commodity that will be purchased at each different price. The demand schedule reflects the property's utility to individuals, and will vary with purchasing power and differences in taste. A supply schedule is a cost schedule indicating quantities producers will supply at different prices.

4. **Anticipation.** The principle of anticipation states that market value equals the present value of future benefits. Commercial development of land creates income, and the anticipated net incomes capitalized into present value equals the market value. The future rents attributed to vacant residential land capitalized into present value equals the market value of vacant residential land.

5. **Substitution.** A property’s value tends to be set by the cost of acquiring an equally desirable substitute. The price, presence, and availability of other land or alternative investments determine the demand for land, and subsequently the value of the land. The principle of substitution provides that the sale price of a property is indicative of the market value of similar properties. The principle assumes that in a competitive market all properties that are close substitutes have approximately the same value and that competitive market properties that have a perfect degree of substitution would have exactly the same value.

Actually, identical properties do not exist, but reasonable substitutes for a property does exist. Due to the nature of the real estate market, and the characteristic of bargaining of most sales, nearly perfect economic substitutes frequently sell for different amounts. Recognizing the non-existence of perfect economic substitutes and the bargaining of most sales, the appraiser places emphasis on the value range. A value range more realistically describes the market value of real estate than a value point. An appraiser attempts to make a reasonable estimate of value that lies somewhere within that value range. Moreover, the range varies with different types of properties. The range will contract for properties in a homogeneous area, and the range will expand for properties in a heterogeneous area.

6. **Surplus productivity.** Income remaining after the costs of labor, capital, and management have been paid from revenue equals surplus productivity. Recognizing land as a fixed asset, surplus productivity exists in the short run, and owners of land might be the beneficiaries of surplus productivity even in the long run. Based on the method of surplus productivity, the residual after the satisfaction of labor, capital, and management equals land value.

7. **Change.** Again, recognizing land as a fixed asset, the dynamic forces of the economy, political environment, and demographics influence the value of land.

The aforementioned definitions and court decisions form a foundation that the remainder of the manual builds upon to explain land valuation. However, in Arizona an appraiser must also consider statutorily mandated valuation methods.

Statutory Valuation Methods. Golf courses, shopping centers, qualified residential common areas, and agricultural land have valuation methods determined by statute. See Part 2, Chapter 2 of the Assessment Procedures Manual published by the Department of Revenue for a discussion of mandated approaches for golf courses and shopping centers. The Agricultural Manual, published by the Department of Revenue, discusses the statutory valuation of agricultural land. For a complete discussion of valuation of qualified common areas, see the Arizona Department of Revenue Property Tax Division Guideline, entitled "Residential Common Areas".